Supreme Court, U.S.
FILED
MAY 13 1999
CLERK

(2)

No. 98-1612

In The

Supreme Court of the United States

DIAMOND MULTIMEDIA SYSTEMS, WILLIAM J. SCHROEDER, GARY B. FILLER and HYUNG HWE HUH,

Petitioners,

vs.

SUPERIOR COURT OF SANTA CLARA COUNTY (PASS),

Respondent.

On Petition For A Writ Of Certiorari To The Supreme Court Of The State Of California

RESPONDENT'S BRIEF IN OPPOSITION

MILBERG WEISS BERSHAD HYNES & LERACH LLP
LEONARD B. SIMON
(*Counsel of Record*)
ALAN SCHULMAN
MARK SOLOMON
WILLIAM S. DATO
600 West Broadway
Suite 1800
San Diego, CA 92101
Telephone: 619/231-1058

ABBEY, GARDY & SQUITIERI, LLP
ARTHUR N. ABBEY
JILL S. ABRAMS
JAMES J. SEIRMARCO
212 East 39th Street
New York, NY 10016
Telephone: 212/889-3700

BERNSTEIN LITOWITZ BERGER & GROSSMANN LLP
DANIEL L. BERGER
JEFFREY N. LEIBELL
1285 Avenue of the Americas
33rd Floor
New York, NY 10019
Telephone: 212/554-1400

Attorneys for Respondent

[Additional Counsel Appear On Signature Page.]

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
OR CALL COLLECT (402) 342-2831

4 DPP

QUESTIONS PRESENTED

1. Do sections 25400(d) and 25500 of the California Corporations Code unconstitutionally burden interstate commerce by prohibiting persons from making false and misleading statements *in California* to manipulate the market price for a security and affording a remedy to persons both inside and outside California who were harmed by that misconduct?

2. Is a securities class action under California Corporations Code sections 25400(d) and 25500, filed before the effective date of the Securities Litigation Uniform Standards Act of 1998, impliedly preempted by the Private Securities Litigation Reform Act of 1995 notwithstanding that the 1998 Act expressly preempts such class actions only if filed after the effective date of that statute?

TABLE OF CONTENTS

Page

I. CONSTITUTIONAL AND STATUTORY PROVISIONS 1

II. STATEMENT OF THE CASE 1

III. SUMMARY OF ARGUMENT 4

IV. REASONS FOR DENYING THE PETITION ... 5

A. No Unconstitutional Burden On Interstate Commerce Arises From California's Application Of Its Law To Fraudulent And Manipulative Conduct By Defendants In California 5

B. The Private Securities Litigation Reform Act Of 1995 Does Not Impliedly Preempt State Law Actions Filed Before The Effective Date Of The Uniform Standards Act 9

V. CONCLUSION 13

TABLE OF AUTHORITIES

Page

CASES

Arizona Corp. Comm'n v. Media Products, Inc., 763 P.2d 527 (Ariz. App. 1988) 7

CTS Corp. v. Dynamics Corp. of America, 481 U.S. 69 (1987) 6

Chrysler Capital Corp. v. Century Power Corp., 800 F.Supp. 1189 (S.D.N.Y. 1992) 7

Cipollone v. Liggett Group, Inc., 505 U.S. 504 (1992) 11

Edgar v. MITE Corp., 457 U.S. 624 (1982) 7

Enntex Oil & Gas Co. v. Texas, 560 S.W.2d 494 (Tex. Civ. App. 1977) 7

Freightliner Corp. v. Myrick, 514 U.S. 280 (1995) 11

Haberman v. Washington Public Power Supply System, 744 P.2d 1032 (Wash. 1987) 6

IIT v. Vencap, Ltd., 519 F.2d 1001 (2d Cir. 1975) 6

Johnson-Bowles Co. v. Division of Securities of Dep't of Commerce, 829 P.2d 101 (Utah App. 1991) 6

Matsushita Elec. Indus. Co., Ltd. v. Epstein, 516 U.S. 367 (1996) 10

Terry v. Yamashita, 643 F.Supp. 161 (D. Haw. 1986) 7

Upton v. Trinidad Petroleum Corp., 468 F. Supp. 330 (N.D. Ala. 1979), *aff'd*, 652 F.2d 424 (5th Cir. 1981) 7

TABLE OF AUTHORITIES – Continued

Page

STATUTES, RULES, REGULATIONS AND LEGISLATIVE MATERIALS

15 U.S.C.
§78bb 3, 9

§78u-4 ..... 3, 9

§78u-5 ..... 3, 9

California Corporations Code
§25400 ..... *passim*

§25500 ..... *passim*

141 Cong. Rec. H2834 (daily ed. Mar. 8, 1995) 10

141 Cong. Rec. H2844 (daily ed. Mar. 8, 1995) 10

141 Cong. Rec. S9319 (daily ed. June 28, 1995) 10

Hearings before the Subcommittee on Telecommunications and Finance of the House of Representatives Commerce Committee, Serial No. 104-2, 104th Cong., 1st Sess. (1995) 10

SECONDARY AUTHORITIES

Restatement (Third) of Foreign Relations Law of the United States (1987)
§416 6

I. CONSTITUTIONAL AND STATUTORY PROVISIONS[1]

In addition to the provisions identified in the petition for certiorari, the relevant statutes include the Securities Litigation Uniform Standards Act of 1998 (Pub. L. 105-353, 112 Stat. 3227), signed into law on November 3, 1998. This statute is reprinted as an appendix to this brief. (B1-B22.)

II. STATEMENT OF THE CASE

The proceeding before the California Supreme Court that gave rise to this petition presented fundamentally an issue of statutory interpretation.[2] One of the two statutes being construed, section 25400(d) of the California Corporations Code, prohibits a person from making false and misleading statements in California that are designed to manipulate the price of a security that person is either buying or selling. (A64.) Section 25500 affords a remedy to "[a]ny person" who purchases any security "at a price which was affected by" the manipulative conduct. (A65.) Affirming lower court rulings, the California Supreme Court held that the plain language of these two statutes

---

[1] Respondent accepts petitioners' statement of jurisdiction.

[2] The writ proceeding arose following the trial court's overruling of defendants' demurrer to plaintiff's complaint. Defendants included Diamond Multimedia Systems, Inc. ("Diamond") and four of its officers and/or directors. Diamond and three of the individual defendants are petitioners in this Court. Plaintiff Joanne Pass (respondent in this Court) brought this action on behalf of a class of Diamond stock purchasers allegedly damaged by defendants' wrongful conduct.

does not include any requirement that all plaintiffs availing themselves of this remedy purchase the security in California. (A23.)

The supposedly crucial constitutional issues raised in the petition were not even mentioned by defendants until their reply brief in the California Supreme Court, and then almost as an afterthought. *See* Reply Memorandum to the Formal Return of Real Parties in Interest at 32-37. Responding to these arguments, the California high court held that sections 25400 and 25500 do not impose an unconstitutional burden on interstate commerce. The court questioned "how permitting persons who purchase or sell stock at a time when the market price is affected by market manipulation occurring in California to recover damages from the California malefactor burdens interstate commerce." (A41.) It also noted California's "clear and substantial interest in preventing fraudulent practices in this state which may have an effect both in California and throughout the country." (A41.)

Rejecting defendants' principal thesis for their Commerce Clause argument (*see* Petn. at 9-11), the California high court held that section 25400 "does not purport to regulate any 'transactions' in securities which occur outside of this state . . . . " (A40; *see also* A24-A25.) Instead, "section 25400 regulates only manipulative conduct in California." (A40.) Assuming arguendo that "California had no interest in protecting investors in other states," the court nonetheless recognized California's "legitimate interest in discouraging unlawful conduct that has a potential to harm California investors as well as persons in other states." (A41-A42.) "Extending the civil liability remedy to all investors," the court noted, "serves that

purpose." (A42.) The court concluded that under these circumstances, any indirect burden on interstate commerce "would not be constitutionally impermissible." (A41.)

The California Supreme Court also rejected defendants' claim that application of sections 25400(d) and 25500 in the circumstances of this case was impliedly preempted by the Private Securities Litigation Reform Act of 1995 ("PSLRA"). 15 U.S.C. §§78u-4 and 78u-5. The court commented that "[t]he Securities Exchange Act of 1934 (15 U.S.C. § 78bb(a)) makes it clear that, except to the extent it has been subsequently modified by the Securities Litigation Uniform Standards Act of 1998, federal law in this arena supplements, but does not displace state regulation and remedies. 'Congress plainly contemplated the possibility of dual litigation in state and federal courts relating to securities. *See* 15 U.S.C. § 78bb(a) (preserving "all other rights and remedies that may exist at law or in equity").' (*Matsushita Electric Industrial Co., Ltd. v. Epstein, supra,* 516 U.S. at p. 383. . . .)" (A30.) Earlier in its opinion the court had referred to the Securities Litigation Uniform Standards Act of 1998 ("SLUSA"), which amended section 28 of the Securities Exchange Act of 1934 ("1934 Act") (78 U.S.C. §78bb) to expressly preempt certain class action lawsuits based on state statutory or common law. (A12-A13 n.12.) This express preemption provision, the court noted, was expressly *not* retroactive to cases like this one filed before the effective date of SLUSA.[3] (A12-A13 n.12.)

---

[3] The court also addressed defendants' assertion that certain allegations in plaintiff's complaint were subject to the

III. SUMMARY OF ARGUMENT

As both the majority and dissenting opinions in the California Supreme Court recognized, the issues presented by this petition are not likely to recur; they principally affect only a "small population" of cases filed before the passage of SLUSA in 1998. (A54; *see also* A12 n.12.) The majority opinion follows well-established precedent in holding that sections 25400 and 25500 do not impermissibly burden interstate commerce by imposing liability for manipulative conduct *engaged in by persons in California* that has an effect inside and outside the state. These statutes do not result in the application of California law to conduct occurring wholly or even substantially outside California, and certainly the allegations of this complaint – involving California defendants and a California company engaging in market manipulation in California – raise no such issue.

Similarly, there is no basis for defendants' contention that state securities law actions were impliedly preempted by the 1995 passage of the PSLRA. The limited express preemption provisions of SLUSA, enacted in 1998 but which are expressly *not* applicable to state law actions filed before SLUSA's effective date, confirm that prior to

---

protections of the "Safe Harbor" provisions of the PSLRA. Defendants suggested that California could not impose liability on them for statements that would be protected by the Safe Harbor. The court responded that by its express terms, the Safe Harbor only applies to private actions arising under the 1934 Act. (A31.) Even to the extent the Safe Harbor applied, the court observed that plaintiff satisfied any burden she had by alleging that the statements were made by defendants with actual knowledge of their falsity. (A32.)

1998 there was no Congressional intent to preempt such actions.

IV. REASONS FOR DENYING THE PETITION

A. No Unconstitutional Burden On Interstate Commerce Arises From California's Application Of Its Law To Fraudulent And Manipulative Conduct By Defendants In California

Defendants contend that the California Supreme Court's decision, permitting a remedy for all persons victimized by fraudulent and manipulative conduct occurring in California regardless of where they purchased their stock, "impermissibly projects California's securities fraud legislation into the commerce of other states." Petn. at 8. It does no such thing. Defendants focus on the fact that sections 25400 and 25500 may afford a remedy to a person who purchases stock outside California. But contrary to defendants' assertion, these California statutes do not thereby "regulate" transactions occurring wholly outside the state. *See* Petn. at 10.

As the California Supreme Court's opinion repeatedly emphasized, "section 25400 regulates only manipulative conduct in California." (A40; *see also* A24-A25.) Where a buyer of securities has been victimized by a fraudulent scheme of market manipulation carried out from California, sections 25400 and 25500 do not reach out to impose liability on the out-of-state seller so as to "regulate" the sales transaction. That transaction is merely the site of the plaintiff's damage. California imposes liability only on the California manipulators for

wrongful conduct occurring in California, and such liability does not burden interstate commerce.

As interpreted by the California Supreme Court, sections 25400 and 25500 do not in any sense discriminate against interstate commerce. *See CTS Corp. v. Dynamics Corp. of America*, 481 U.S. 69, 87 (1987) ("The principal objects of dormant Commerce Clause scrutiny are statutes that discriminate against interstate commerce."). Rather, as the court was careful to note, prohibiting fraudulent practices in California that affect residents and nonresidents alike *facilitates* interstate commerce.[4] (A41.)

Not surprisingly, every court to consider a Commerce Clause challenge to a similar fraud or manipulation-based statute has rejected it. *See Johnson-Bowles Co. v. Division of Securities of Dep't of Commerce*, 829 P.2d 101, 110-11 (Utah App. 1991); *Haberman v. Washington Public Power Supply System*, 744 P.2d 1032, 1053-54 (Wash. 1987);

---

[4] To say that sections 25400(d) and 25500 impermissibly "regulate" wholly out-of-state transactions would be the same as saying that the imposition of liability under section 10(b) of the 1934 Act and Rule 10b-5 on American defendants engaged in fraudulent conduct within the United States inappropriately "regulates" wholly foreign transactions if foreign investors are afforded a remedy. Yet it is well established that United States securities laws apply to "conduct occurring predominantly in the United States that is related to a transaction in securities, even if the transaction takes place outside the United States." Restatement (Third) of Foreign Relations Law of the United States, §416(1)(d) (1987); *see also, e.g., IIT v. Vencap, Ltd.*, 519 F.2d 1001, 1017 (2d Cir. 1975) ("We do not think Congress intended to allow the United States to be used as a base for manufacturing fraudulent security devices for export, even when these are peddled only to foreigners.").

Enntex Oil & Gas Co. v. Texas, 560 S.W.2d 494, 497 (Tex. Civ. App. 1977); *Upton v. Trinidad Petroleum Corp.*, 468 F. Supp. 330, 335-36 (N.D. Ala. 1979), *aff'd*, 652 F.2d 424 (5th Cir. 1981). As one court explained in analyzing a similar statute, "like any tort recovery statute, it merely provides a post-hoc remedy for persons aggrieved by allegedly unlawful conduct. Thus, in no sense does it prevent or burden interstate commerce."[5] *Chrysler Capital Corp. v. Century Power Corp.*, 800 F. Supp. 1189, 1195 (S.D.N.Y. 1992).

Seeking to find something objectionable in the unobjectionable, defendants take issue with a single passage in the opinion in which the California Supreme Court explained that a statement is made "in this state" if the statement "is made by a person in California or is willfully disseminated in California . . . . " (A21.) Focusing on the word "disseminated," defendants claim that "[s]ection 25400, as interpreted by the majority, applies to conduct occurring wholly outside California . . . . " Petn. at 12. They then create a "parade of horribles" argument in which a New York company could be liable to a New York purchaser for merely making a statement to the *Wall*

---

[5] None of the cases relied on by defendants involve tort recovery statutes that impose liability for wrongful conduct occurring within the state. *See* Petn. at 9-10. Rather they involve state attempts to regulate out-of-state transactions on the basis that the corporation whose stock is being traded is a domestic corporation. *See Edgar v. MITE Corp.*, 457 U.S. 624 (1982) (Illinois anti-takeover statute); *Terry v. Yamashita*, 643 F. Supp. 161 (D. Haw. 1986) (Hawaii control share acquisition statute); *Arizona Corp. Comm'n v. Media Products, Inc.*, 763 P.2d 527 (Ariz. App. 1988) (Arizona securities registration statute).

Street Journal or posting a fraudulent statement on an internet website that can be accessed from California. Petn. at 12-13.

In contrast to the one passage on which defendants focus, the California Supreme Court's opinion is replete with references demonstrating that the defendant must engage in wrongful conduct *in California* before liability under sections 25400 and 25500 will attach. (*E.g.*, A15 (section 25400(d) "makes it unlawful *in California* to knowingly make false or misleading statements"); A18-A19 (conduct is criminal "if, *in California*, the defendant acted with the intent to induce any purchase or sale of stock"); A19 (Legislature made "acts of market manipulation *in California* a felony"); A22 ("section 25400 prohibits commission of manipulative acts *in California*"); A27 (statutes were "intended to protect all persons affected by market manipulation that occurs *in California*"); A34 (liability is imposed where "the conduct which gives rise to liability under section 25400 occurs *in California*"); A35 n.20 (statutes "provide a remedy for a wrongful act committed *in California*") (all emphasis added).) Read in proper context, the court's reference to "disseminated" likely refers to a situation where, although the defendant's statement might have been drafted elsewhere, it was published in and emanated from California.[6]

---

[6] Indeed, when amici in support of defendants first raised the "parade of horribles" argument before the California Supreme Court, plaintiff expressly disclaimed any argument that such out-of-state statements were "made" in California for purposes of section 25400(d). *See* Real Parties' Answer to Amicus Briefs in Support of Defendants' Petition for Writ of Mandate at 4 n.3.

In any event, it is quite clear that the issue defendants seek to raise is not presented by the facts of this case. Plaintiff's complaint alleged that Diamond is a corporation headquartered in San Jose, California, that all the individual defendants were California residents and, accordingly, that the allegedly false and misleading statements were made in California. 1 App. 7, 9.[7] This case hardly presents an appropriate vehicle to consider a Commerce Clause challenge to the interpretation of a statute not argued for by plaintiff and based on ambiguous dicta unnecessary to the court's decision.

B. The Private Securities Litigation Reform Act Of 1995 Does Not Impliedly Preempt State Law Actions Filed Before The Effective Date Of The Uniform Standards Act

In 1995, Congress passed the PSLRA. By its express terms, the PSLRA applies only to "private action[s] arising under this title," that is, private actions brought pursuant to the 1934 Act. *See* 15 U.S.C. §§78u-4(a)(1) and 78u-5(c). It therefore was not intended to apply to state court actions brought pursuant to state securities fraud statutes.[8] More importantly, the PSLRA did not alter section 28(a) of the 1934 Act (15 U.S.C. §78bb(a)), which at

---

[7] Citations in the form "___ App. ___" refer to the record in the underlying writ proceeding, the Appendix of Exhibits to Petition for Peremptory Writ of Mandate originally filed by defendants in the California Court of Appeal, Sixth Appellate District.

[8] The legislative history of the PSLRA confirms Congress's understanding that the PSLRA would *not* preempt state law remedies. For example, referring to the proposed Safe Harbor provision, Representative Mineta endorsed the limitation on

the time provided that "[t]he rights and remedies provided by this title shall be in addition to any and all other rights and remedies that may exist at law or in equity . . . . " Interpreting section 28(a), this Court explained that "Congress plainly contemplated the possibility of dual litigation in state and federal courts relating to securities transactions." *Matsushita Elec. Indus. Co., Ltd. v. Epstein*, 516 U.S. 367, 383 (1996).

Three years later, Congress *did* amend section 28(a) when it passed SLUSA, which expressly preempts certain types of large-scale securities class actions based on state law. (B8-B13.) However, aware that a number of securities class action lawsuits were then pending in various state courts, Congress expressly exempted these cases from the

---

liability for forward-looking statements in part because "there are State regulations or there is common law fraud that would still subject the maker of those kinds of statements to action." *See* 141 Cong. Rec. H2844 (daily ed. Mar. 8, 1995). The legislative history materials contain numerous other statements by members of Congress in a wide variety of contexts reflecting the understanding that the PSLRA was not intended to preempt state law. *See, e.g.*, Hearings before the Subcommittee on Telecommunications and Finance of the House of Representatives Commerce Committee, Serial No. 104-2, 104th Cong., 1st Sess., at 109 (1995) (colloqūy between Representative Cox and University of Chicago Professor Daniel Fischel expressing the understanding that a proposed attorneys' fee provision would not affect actions brought under state law); 141 Cong. Rec. S9319 (daily ed. June 28, 1995) (comments of Senator Rockefeller noting that certain of his colleagues supported a shorter federal statute of limitations because "there are other adequate remedies including State actions"); 141 Cong. Rec. H2834 (daily ed. Mar. 8, 1995) (statement by Representative Cox that legislation would not affect actions filed in Orange County superior court).

preemptive effect of SLUSA by providing that its provisions did not "affect or apply to any action commenced before and pending on the date of enactment of this Act." (B13.)

Preemption is fundamentally an issue of Congressional intent. *Cipollone v. Liggett Group, Inc.*, 505 U.S. 504, 516 (1992). In the face of the recognition by Congress manifested on two different occasions that state law securities actions filed before the effective date of SLUSA would be permitted, defendants now argue that Congress intended such suits to be impliedly preempted because they are fundamentally and necessarily inconsistent with Congress's purpose in enacting the PSLRA in 1995. Petn. at 18-24.

It is difficult to conceive of how Congress could have more clearly expressed its contrary intent.[9] Not only does

---

[9] *Freightliner Corp. v. Myrick*, 514 U.S. 280 (1995), relied on by defendants, does not suggest a different result. That decision merely indicates that the existence of an express preemption clause does not absolutely foreclose a claim of implied preemption. *Id.* at 287-89. This Court recognized, however, that Congress's enactment of an express preemption provision supports the reasonable inference that it did not intend to preempt other matters (*id.* at 288) and the opinion ultimately concludes that there is no implied preemption because the state law action was not necessarily inconsistent with the Congressional purpose. *Id.* at 289-90. Moreover, here we have more than an express preemption provision. We also have an additional express statement by Congress that preemption does not apply to cases like this one filed before the effective date of SLUSA. Congress could not have enacted the express statement of prospective application had it intended that the earlier-filed actions be preempted.

the 1934 Act contain an express non-preemption clause that was left unchanged in 1995, but as the California Supreme Court explained:

> Congress has chosen [in 1998] both to permit continuance of pending class actions . . . and to leave individual actions unrestricted. The suggestion that federal securities law already impliedly preempted all such actions under the Corporate Securities Law of 1968 ignores this clear Congressional recognition that, except to the extent that [SLUSA] limits class actions, there is no preemption.

(A13 n.12.) It is only by ignoring the overwhelming contrary evidence that defendants can suggest Congress intended in 1995 to preempt state securities fraud actions.[10]

---

[10] Defendants go on to argue that even if all California state securities actions are not impliedly preempted, there is preemption to the extent that California would impose liability for statements that would be protected by the PSLRA's Safe Harbor provisions had plaintiff's claim been brought pursuant to the federal securities laws. The California Supreme Court was skeptical of this assertion in light of Congress's expressed intent that the PSLRA only apply to actions brought pursuant to the 1934 Act. (A31.) A more reasonable inference, supported by the "cumulative" language in section 28(a) of the 1934 Act, is that Congress was only specifying what would give rise to liability under federal law, and was not precluding states from creating standards of civil liability more protective of investors than federal law.

In any event, even if the Safe Harbor fully applied, it would not result in dismissal of plaintiff's complaint, which alleges numerous false and misleading statements that are not forward-looking statements within the meaning of the Safe Harbor provisions. (A93-A94.) *See, e.g.*, 1 App. 4, 15-16, 32-33. Moreover,

V. CONCLUSION

In an appellate proceeding devoted primarily to determining what the California Legislature intended when it enacted sections 25400 and 25500 of the California Corporations Code, the California Supreme Court correctly determined that these statutes as interpreted did not unconstitutionally burden interstate commerce and were not impliedly preempted by the PSLRA. Those conclusions were manifestly correct, and there is no need or basis for this Court's intervention. We respectfully urge that the petition be denied.

DATED: May 13, 1999

Respectfully submitted,

MILBERG WEISS BERSHAD
HYNES & LERACH LLP
LEONARD B. SIMON
(*Counsel of Record*)
ALAN SCHULMAN
MARK SOLOMON
WILLIAM S. DATO
600 West Broadway, Suite 1800
San Diego, CA 92101
Telephone: 619/231-1058

---

contrary to the defendants' suggestion (Petn. at 26), it would not be incumbent on plaintiff to affirmatively plead that any forward-looking statements in the complaint were not identified as forward-looking or that meaningful cautionary language was missing. The California Supreme Court's opinion nowhere suggests that the issue defendants identify cannot be raised by means of their answer or as an affirmative defense.

ABBEY, GARDY & SQUITIERI, LLP
ARTHUR N. ABBEY
JILL S. ABRAMS
JAMES J. SEIRMARCO
212 East 39th Street
New York, NY 10016
Telephone: 212/889-3700

BERNSTEIN LITOWITZ BERGER
& GROSSMANN LLP
DANIEL L. BERGER
JEFFREY N. LEIBELL
1285 Avenue of the Americas
33rd Floor
New York, NY 10019
Telephone: 212/554-1400

FARUQI & FARUQI, LLP
NADEEM FARUQI
415 Madison Avenue
21st Floor
New York, NY 10017
Telephone: 212/986-1074

STULL, STULL & BRODY
JULES BRODY
6 East 45th Street
4th Floor
New York, NY 10017
Telephone: 212/687-7230

Attorneys for Respondent

APPENDIX

Pub. L. No. 105-353, 112 Stat. 3227.

One Hundred Fifth Congress of the United States of America

AT THE SECOND SESSION

Begun and held at the City of Washington on Tuesday, the twenty-seventh day of January, one thousand nine hundred and ninetyeight

An Act to amend the Securities Act of 1933 and the Securities Exchange Act of 1934 to limit the conduct of securities class actions under State law, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Securities Litigation Uniform Standards Act of 1998".

SEC. 2. FINDINGS.

The Congress finds that –

(1) the Private Securities Litigation Reform Act of 1995 sought to prevent abuses in private securities fraud lawsuits;

(2) since enactment of that legislation, considerable evidence has been presented to Congress that a number of securities class action lawsuits have shifted from Federal to State courts;

(3) this shift has prevented that Act from fully achieving its objectives;

(4) State securities regulation is of continuing importance, together with Federal regulation of securities, to protect investors and promote strong financial markets; and

(5) in order to prevent certain State private securities class action lawsuits alleging fraud from being used to frustrate the objectives of the Private Securities Litigation Reform Act of 1995, it is appropriate to enact national standards for securities class action lawsuits involving nationally traded securities, while preserving the appropriate enforcement powers of State securities regulators and not changing the current treatment of individual lawsuits.

TITLE I – SECURITIES LITIGATION UNIFORM STANDARDS

SEC. 101. LIMITATION ON REMEDIES.

(a) Amendments to the Securities Act of 1933. –

(1) Amendment. – Section 16 of the Securities Act of 1933 (15 U.S.C. 77p) is amended to read as follows:

"SEC. 16. ADDITIONAL REMEDIES; LIMITATION ON REMEDIES.

"(a) Remedies Additional. – Except as provided in subsection (b), the rights and remedies provided by this title shall be in addition to any and all other rights and remedies that may exist at law or in equity.

"(b) Class Action Limitations. – No covered class action based upon the statutory or common law of any

State or subdivision thereof may be maintained in any State or Federal court by any private party alleging –

> "(1) an untrue statement or omission of a material fact in connection with the purchase or sale of a covered security; or
>
> "(2) that the defendant used or employed any manipulative or deceptive device or contrivance in connection with the purchase or sale of a covered security.

"(c) Removal of Covered Class Actions. – Any covered class action brought in any State court involving a covered security, as set forth in subsection (b), shall be removable to the Federal district court for the district in which the action is pending, and shall be subject to subsection (b).

"(d) Preservation of Certain Actions. –

"(1) Actions under state law of state of incorporation. –

"(A) Actions preserved. – Notwithstanding subsection (b) or (c), a covered class action described in subparagraph (B) of this paragraph that is based upon the statutory or common law of the State in which the issuer is incorporated (in the case of a corporation) or organized (in the case of any other entity) may be maintained in a State or Federal court by a private party.

"(B) Permissible actions. – A covered class action is described in this subparagraph if it involves –

> "(i) the purchase or sale of securities by the issuer or an affiliate of the issuer exclusively from or to holders of equity securities of the issuer; or

"(ii) any recommendation, position, or other communication with respect to the sale of securities of the issuer that –

"(I) is made by or on behalf of the issuer or an affiliate of the issuer to holders of equity securities of the issuer; and

"(II) concerns decisions of those equity holders with respect to voting their securities, acting in response to a tender or exchange offer, or exercising dissenters' or appraisal rights.

"(2) State actions –

"(A) In general. – Notwithstanding any other provision of this section, nothing in this section may be construed to preclude a State or political subdivision thereof or a State pension plan from bringing an action involving a covered security on its own behalf, or as a member of a class comprised solely of other States, political subdivisions, or State pension plans that are named plaintiffs, and that have authorized participation, in such action.

"(B) State pension plan defined. – For purposes of this paragraph, the term 'State pension plan' means a pension plan established and maintained for its employees by the government of the State or political subdivision thereof, or by any agency or instrumentality thereof.

"(3) Actions under contractual agreements between issuers and indenture trustees. – Notwithstanding subsection (b) or (c), a covered class action that seeks to enforce a contractual agreement between an issuer and an indenture trustee may be maintained in a State or Federal

court by a party to the agreement or a successor to such party.

"(4) Remand of removed actions. – In an action that has been removed from a State court pursuant to subsection (c), if the Federal court determines that the action may be maintained in State court pursuant to this subsection, the Federal court shall remand such action to such State court.

"(e) Preservation of State Jurisdiction. – The securities commission (or any agency or office performing like functions) of any State shall retain jurisdiction under the laws of such State to investigate and bring enforcement actions.

"(f) Definitions. – For purposes of this section, the following definitions shall apply:

"(1) Affiliate of the issuer. – The term 'affiliate of the issuer' means a person that directly or indirectly, through one or more intermediaries, controls or is controlled by or is under common control with, the issuer.

"(2) Covered class action. –

"(A) In general. – The term 'covered class action' means –

"(i) any single lawsuit in which –

"(I) damages are sought on behalf of more than 50 persons or prospective class members, and questions of law or fact common to those persons or members of the prospective class, without reference to issues of individualized reliance on an alleged misstatement or omission, predominate over any

questions affecting only individual persons or members; or

"(II) one or more named parties seek to recover damages on a representative basis on behalf of themselves and other unnamed parties similarly situated, and questions of law or fact common to those persons or members of the prospective class predominate over any questions affecting only individual persons or members; or

"(ii) any group of lawsuits filed in or pending in the same court and involving common questions of law or fact, in which –

"(I) damages are sought on behalf of more than 50 persons; and

"(II) the lawsuits are joined, consolidated, or otherwise proceed as a single action for any purpose.

"(B) Exception for derivative actions. – Notwithstanding subparagraph (A), the term 'covered class action' does not include an exclusively derivative action brought by one or more shareholders on behalf of a corporation.

"(C) Counting of certain class members. – For purposes of this paragraph, a corporation, investment company, pension plan, partnership, or other entity, shall be treated as one person or prospective class member, but only if the entity is not established for the purpose of participating in the action.

"(D) Rule of construction. – Nothing in this paragraph shall be construed to affect the discretion of a State court in determining whether actions filed in such court

should be joined, consolidated, or otherwise allowed to proceed as a single action.

"(3) Covered security. – The term 'covered security' means a security that satisfies the standards for a covered security specified in paragraph (1) or (2) of section 18(b) at the time during which it is alleged that the misrepresentation, omission, or manipulative or deceptive conduct occurred, except that such term shall not include any debt security that is exempt from registration under this title pursuant to rules issued by the Commission under section 4(2).".

(2) Circumvention of stay of discovery. – Section 27(b) of the Securities Act of 1933 (15 U.S.C. 77z-1(b)) is amended by inserting after paragraph (3) the following new paragraph:

> "(4) Circumvention of stay of discovery. – Upon a proper showing, a court may stay discovery proceedings in any private action in a State court as necessary in aid of its jurisdiction, or to protect or effectuate its judgments, in an action subject to a stay of discovery pursuant to this subsection.".

(3) Conforming amendments. – Section 22(a) of the Securities Act of 1933 (15 U.S.C. 77v(a)) is amended –

(A) by inserting "except as provided in section 16 with respect to covered class actions," after "Territorial courts,"; and

(B) by striking "No case" and inserting "Except as provided in section 16(c), no case".

(b) Amendments to the Securities Exchange Act of 1934. –

(1) Amendment. – Section 28 of the Securities Exchange Act of 1934 (15 U.S.C. 78bb) is amended –

(A) in subsection (a), by striking "The rights and remedies" and inserting "Except as provided in subsection (f), the rights and remedies"; and

(B) by adding at the end the following new subsection:

"(f) Limitations on Remedies. –

"(1) Class action limitations. – No covered class action based upon the statutory or common law of any State or subdivision thereof may be maintained in any State or Federal court by any private party alleging –

"(A) a misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security; or

"(B) that the defendant used or employed any manipulative or deceptive device or contrivance in connection with the purchase or sale of a covered security.

"(2) Removal of covered class actions. – Any covered class action brought in any State court involving a covered security, as set forth in paragraph (1), shall be removable to the Federal district court for the district in which the action is pending, and shall be subject to paragraph (1).

"(3) Preservation of certain actions. –

"(A) Actions under state law of state of incorporation. –

"(i) Actions preserved. – Notwithstanding paragraph (1) or (2), a covered class action described in clause (ii) of this subparagraph that is based upon the statutory or common law of the State in which the issuer is incorporated (in the case of a corporation) or organized (in the case of any entity) may be maintained in a State or Federal court by a private party.

"(ii) Permissible actions. – A covered class action is described in this clause if it involves –

"(I) the purchase or sale of securities by the issuer or an affiliate of the issuer exclusively from or to holders of equity securities of the issuer; or

"(II) any recommendation, position, or other communication with respect to the sale of securities of an issuer that –

"(aa) is made by or on behalf of the issuer or an affiliate of the issuer to holders of equity securities of the issuer; and

"(bb) concerns decisions of such equity holders with respect to voting their securities, acting in response to a tender or exchange offer, or exercising dissenters' or appraisal rights.

"(B) State actions. –

"(i) In general. – Notwithstanding any other provision of this subsection, nothing in this subsection may be construed to preclude a State or political subdivision thereof or a State pension plan from bringing an action involving a covered security on its own behalf, or as a member of a class comprised solely of other States, political subdivisions, or State pension plans that are named

plaintiffs, and that have authorized participation, in such action.

"(ii) State pension plan defined. – For purposes of this subparagraph, the term 'State pension plan' means a pension plan established and maintained for its employees by the government of a State or political subdivision thereof, or by any agency or instrumentality thereof.

"(C) Actions under contractual agreements between issuers and indenture trustees. – Notwithstanding paragraph (1) or (2), a covered class action that seeks to enforce a contractual agreement between an issuer and an indenture trustee may be maintained in a State or Federal court by a party to the agreement or a successor to such party.

"(D) Remand of removed actions. – In an action that has been removed from a State court pursuant to paragraph (2), if the Federal court determines that the action may be maintained in State court pursuant to this subsection, the Federal court shall remand such action to such State court.

"(4) Preservation of state jurisdiction. – The securities commission (or any agency or office performing like functions) of any State shall retain jurisdiction under the laws of such State to investigate and bring enforcement actions.

"(5) Definitions. – For purposes of this subsection, the following definitions shall apply:

"(A) Affiliate of the issuer. – The term 'affiliate of the issuer' means a person that directly or indirectly,

through one or more intermediaries, controls or is controlled by or is under common control with, the issuer.

"(B) Covered class action. – The term 'covered class action' means –

"(i) any single lawsuit in which –

"(I) damages are sought on behalf of more than 50 persons or prospective class members, and questions of law or fact common to those persons or members of the prospective class, without reference to issues of individualized reliance on an alleged misstatement or omission, predominate over any questions affecting only individual persons or members; or

"(II) one or more named parties seek to recover damages on a representative basis on behalf of themselves and other unnamed parties similarly situated, and questions of law or fact common to those persons or members of the prospective class predominate over any questions affecting only individual persons or members; or

"(ii) any group of lawsuits filed in or pending in the same court and involving common questions of law or fact, in which –

"(I) damages are sought on behalf of more than 50 persons; and

"(II) the lawsuits are joined, consolidated, or otherwise proceed as a single action for any purpose.

"(C) Exception for derivative actions. – Notwithstanding subparagraph (B), the term 'covered class action' does not include an exclusively derivative action brought by one or more shareholders on behalf of a corporation.

"(D) Counting of certain class members. – For purposes of this paragraph, a corporation, investment company, pension plan, partnership or other entity, shall be treated as one person or prospective class member, but only if the entity is not established for the purpose of participating in the action.

"(E) Covered security. – The term 'covered security' means a security that satisfies the standards for a covered security specified in paragraph (1) or (2) of section 18(b) of the Securities Act of 1933, at the time during which it is alleged that the misrepresentation, omission, or manipulative or deceptive conduct occurred, except that such term shall not include any debt security that is exempt from registration under the Securities Act of 1933 pursuant to rules issued by the Commission under section 4(2) of that Act.

"(F) Rule of construction. – Nothing in this paragraph shall be construed to affect the discretion of a State court in determining whether actions filed in such court should be joined, consolidated, or otherwise allowed to proceed as a single action.".

(2) Circumvention of stay of discovery. – Section 21D(b)(3) of the Securities Exchange Act of 1934 (15 U.S.C. 78u-4(b)(3)) is amended by adding at the end the following new subparagraph:

"(D) Circumvention of stay of discovery. – Upon a proper showing, a court may stay discovery proceedings in any private action in a State court, as necessary in aid of its jurisdiction, or to protect or effectuate its judgments, in an action subject to a stay of discovery pursuant to this paragraph.".

(c) Applicability. – The amendments made by this section shall not affect or apply to any action commenced before and pending on the date of enactment of this Act.

SEC. 102. PROMOTION OF RECIPROCAL SUBPOENA ENFORCEMENT.

(a) Commission Action. – The Securities and Exchange Commission, in consultation with State securities commissions (or any agencies or offices performing like functions), shall seek to encourage the adoption of State laws providing for reciprocal enforcement by State securities commissions of subpoenas issued by another State securities commission seeking to compel persons to attend, testify in, or produce documents or records in connection with an action or investigation by a State securities commission of an alleged violation of State securities laws.

(b) Report. – Not later than 24 months after the date of enactment of this Act, the Securities and Exchange Commission (hereafter in this section referred to as the "Commission") shall submit a report to the Congress –

(1) identifying the States that have adopted laws described in subsection (a);

(2) describing the actions undertaken by the Commission and State securities commissions to promote the adoption of such laws; and

(3) identifying any further actions that the Commission recommends for such purposes.

TITLE II – REAUTHORIZATION OF THE SECURITIES AND EXCHANGE COMMISSION

SEC. 201. AUTHORIZATION OF APPROPRIATIONS.

Section 35 of the Securities Exchange Act of 1934 (15 U.S.C. 78kk) is amended to read as follows:

"SEC. 35. AUTHORIZATION OF APPROPRIATIONS.

"(a) In General. – In addition to any other funds authorized to be appropriated to the Commission, there are authorized to be appropriated to carry out the functions, powers, and duties of the Commission, $351,280,000 for fiscal year 1999.

"(b) Miscellaneous Expenses. – Funds appropriated pursuant to this section are authorized to be expended –

"(1) not to exceed $3,000 per fiscal year, for official reception and representation expenses;

"(2) not to exceed $10,000 per fiscal year, for funding a permanent secretariat for the International Organization of Securities commissions; and

"(3) not to exceed $100,000 per fiscal year, for expenses for consultations and meetings hosted by the Commission with foreign governmental and other regulatory officials, members of their delegations, appropriate representatives, and staff to exchange views concerning developments relating to securities matters, for development and implementation of cooperation agreements concerning securities matters, and provision of technical assistance for the development of foreign securities markets, such expenses to include necessary logistic and administrative expenses and the expenses of Commission

staff and foreign invitees in attendance at such consultations and meetings, including –

"(A) such incidental expenses as meals taken in the course of such attendance;

"(B) any travel or transportation to or from such meetings; and

"(C) any other related lodging or subsistence.".

SEC. 202. REQUIREMENTS FOR THE EDGAR SYSTEM.

Section 35A of the Securities Exchange Act of 1934 (15 U.S.C. 78ll) is amended –

(1) by striking subsections (a), (b), (c), and (e); and

(2) in subsection (d) –

(A) by striking "(d)";

(B) in paragraph (2), by striking "; and" at the end and inserting a period; and

(C) by striking paragraph (3).

SEC. 203. COMMISSION PROFESSIONAL ECONOMISTS.

Section 4(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78d(b)) is amended –

(1) by redesignating paragraph (2) as paragraph (3); and

(2) by inserting after paragraph (1) the following:

"(2) Economists. –

"(A) Commission authority. – Notwithstanding the provisions of chapter 51 of title 5, United States Code, the Commission is authorized –

"(i) to establish its own criteria for the selection of such professional economists as the Commission deems necessary to carry out the work of the Commission;

"(ii) to appoint directly such professional economists as the Commission deems qualified; and

"(iii) to fix and adjust the compensation of any professional economist appointed under this paragraph, without regard to the provisions of chapter 54 of title 5, United States Code, or subchapters II, III, or VIII of chapter 53, of title 5, United States Code.

"(B) Limitation on compensation. – No base compensation fixed for an economist under this paragraph may exceed the pay for Level IV of the Executive Schedule, and no payments to an economist appointed under this paragraph shall exceed the limitation on certain payments in section 5307 of title 5, United States Code.

"(C) Other benefits. – All professional economists appointed under this paragraph shall remain within the existing civil service system with respect to employee benefits.".

TITLE III – CLERICAL AND TECHNICAL AMENDMENTS

SEC. 301. CLERICAL AND TECHNICAL AMENDMENTS.

(a) Securities Act of 1933. – The Securities Act of 1933 (15 U.S.C. 77 et seq.) is amended as follows:

(1) Section 2(a)(15)(i) (15 U.S.C. 77b(a)(15)(i)) is amended –

(A) by striking "3(a)(2) of the Act" and inserting "3(a)(2)"; and

(B) by striking "section 2(13) of the Act" and inserting "paragraph (13) of this subsection".

(2) Section 11(f)(2)(A) (15 U.S.C. 77k(f)(2)(A)) is amended by striking "section 38" and inserting "section 21D(f)".

(3) Section 13 (15 U.S.C. 77m) is amended –

(A) by striking "section 12(2)" each place it appears and inserting "section 12(a)(2)"; and

(B) by striking "section 12(1)" each place it appears and inserting "section 12(a)(1)".

(4) Section 18 (15 U.S.C. 77r) is amended –

(A) in subsection (b)(1)(A), by inserting ", or authorized for listing," after "Exchange, or listed";

(B) in subsection (c)(2)(B)(i), by striking "Capital Markets Efficiency Act of 1996" and inserting "National Securities Markets Improvements Act of 1996";

(C) in subsection (c)(2)(C)(i), by striking "Market" and inserting "Markets";

(D) in subsection (d)(1)(A) –

(i) by striking "section 2(10)" and inserting "section 2(a)(10)"; and

(ii) by striking "subparagraphs (A) and (B)" and inserting "subparagraphs (a) and (b)";

(E) in subsection (d)(2), by striking "Securities Amendments Act of 1996" and inserting "National Securities Markets Improvement Act of 1996"; and

(F) in subsection (d)(4), by striking "For purposes of this paragraph, the" and inserting "The".

(5) Sections 27, 27A, and 28 (15 U.S.C. 77z-1, 77z-2, 77z-3) are transferred to appear after section 26, in that order.

(6) Paragraph (28) of schedule A of such Act (15 U.S.C. 77aa(28)) is amended by striking "identic" and inserting "identical".

(b) Securities Exchange Act of 1934. – The Securities Exchange Act of 1934 (15 U.S.C. 78 et seq.) is amended as follows:

(1) Section 3(a)(10) (15 U.S.C. 78c(a)(10)) is amended by striking "deposit, for" and inserting "deposit for".

(2) Section 3(a)(12)(A)(vi) (15 U.S.C. 78c(a)(12)(A)(vi)) is amended by moving the margin 2 em spaces to the left.

(3) Section 3(a)(22)(A) (15 U.S.C. 78c(a)(22)(A)) is amended –

(A) by striking "section 3(h)" and inserting "section 3"; and

(B) by striking "section 3(t)" and inserting "section 3".

(4) Section 3(a)(39)(B)(i) (15 U.S.C. 78c(a)(39)(B)(i)) is amended by striking "an order to the Commission" and inserting "an order of the Commission".

(5) The following sections are each amended by striking "Federal Reserve Board" and inserting "Board of Governors of the Federal Reserve System": subsections (a) and (b) of section 7 (15 U.S.C. 78g (a), (b)); section 17(g) (15 U.S.C. 78q(g)); and section 26 (15 U.S.C. 78z).

(6) The heading of subsection (d) of section 7 (15 U.S.C. 78g(d)) is amended by striking "Exception" and inserting "Exceptions".

(7) Section 14(g)(4) (15 U.S.C. 78n(g)(4)) is amended by striking "consolidation sale," and inserting "consolidation, sale,".

(8) Section 15 (15 U.S.C. 78o) is amended –

(A) in subsection (c)(8), by moving the margin 2 em spaces to the left;

(B) in subsection (h)(2), by striking "affecting" and inserting "effecting";

(C) in subsection (h)(3)(A)(i)(II)(bb), by inserting "or" after the semicolon;

(D) in subsection (h)(3)(A)(ii)(I), by striking "maintains" and inserting "maintained";

(E) in subsection (h)(3)(B)(ii), by striking "association" and inserting "associated".

(9) Section 15B(c)(4) (15 U.S.C. 78o-4(c)(4)) is amended by striking "convicted by any offense" and inserting "convicted of any offense".

(10) Section 15C(f)(5) (15 U.S.C. 78o-5(f)(5)) is amended by striking "any person or class or persons" and inserting "any person or class of persons".

(11) Section 19(c)(5) (15 U.S.C. 78s(c)(5)) is amended by moving the margin 2 em spaces to the right.

(12) Section 20 (15 U.S.C. 78t) is amended by redesignating subsection (f) as subsection (e).

(13) Section 21D (15 U.S.C. 78u-4) is amended –

(A) in subsection (g)(2)(B)(i), by striking "paragraph (1)" and inserting "subparagraph (A)".

(B) by redesignating subsection (g) as subsection (f); and (14) Section 31(a) (15 U.S.C. 78ee(a)) is amended by striking "this subsection" and inserting "this section".

(c) Investment Company Act of 1940. – The Investment Company Act of 1940 (15 U.S.C. 80a-1 et seq.) is amended as follows:

(1) Section 2(a)(8) (15 U.S.C. 80a-2(a)(8)) is amended by striking "Unitde" and inserting "United".

(2) Section 3(b) (15 U.S.C. 80a-3(b)) is amended by striking "paragraph (3) of subsection (a)" and inserting "paragraph (1)(C) of subsection (a)".

(3) Section 12(d)(1)(G)(i)(III)(bb) (15 U.S.C. 80a-12(d)(1)(G)(i)(III)(bb)) is amended by striking "the acquired fund" and inserting "the acquired company".

(4) Section 18(e)(2) (15 U.S.C. 80a-18(e)(2)) is amended by striking "subsection (e)(2)" and inserting "paragraph (1) of this subsection".

(5) Section 30 (15 U.S.C. 80a-29) is amended –

(A) by inserting "and" after the semicolon at the end of subsection (b)(1);

(B) in subsection (e), by striking "semi-annually" and inserting "semiannually"; and

(C) by redesignating subsections (g) and (h), as added by section 508(g) of the National Securities Markets Improvement Act of 1996, as subsections (i) and (j), respectively.

(6) Section 31(f) (15 U.S.C. 80a-30(f)) is amended by striking "subsection (c)" and inserting "subsection (e)".

(d) Investment Advisers Act of 1940. – The Investment Advisers Act of 1940 (15 U.S.C. 80b et seq.) is amended as follows:

(1) Section 203(e)(8)(B) (15 U.S.C. 80b-3(e)(8)(B)) is amended by inserting "or" after the semicolon.

(2) Section 222(b)(2) (15 U.S.C. 80b-18a(b)(2)) is amended by striking "principle" and inserting "principal".

(e) Trust Indenture Act of 1939. – The Trust Indenture Act of 1939 (15 U.S.C. 77aaa et seq.) is amended as follows:

(1) Section 303 (15 U.S.C. 77ccc) is amended by striking "section 2" each place it appears in paragraphs (2) and (3) and inserting "section 2(a)".

(2) Section 304(a)(4)(A) (15 U.S.C. 77ddd(a)(4)(A)) is amended by striking "(14) of subsection" and inserting "(13) of section".

(3) Section 313(a) (15 U.S.C. 77mmm(a)) is amended –

(A) by inserting "any change to" after the paragraph designation at the beginning of paragraph (4); and

(B) by striking "any change to" in paragraph (6).

(4) Section 319(b) (15 U.S.C. 77sss(b)) is amended by striking "the Federal Register Act" and inserting "chapter 15 of title 44, United States Code,".

SEC. 302. EXEMPTION OF SECURITIES ISSUED IN CONNECTION WITH CERTAIN STATE HEARINGS.

Section 18(b)(4)(C) of the Securities Act of 1933 (15 U.S.C. 77r(b)(4)(C)) is amended by striking "paragraph (4) or (11)" and inserting "paragraph (4), (10), or (11)".

Speaker of the House of Representatives.

Vice President of the United States and President of the Senate.